



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Number: **201302040**  
Release Date: 1/11/2013  
Date: October 19, 2012

Contact Person:  
Identification Number:  
Contact Number:  
Employer Identification Number:  
Form Required To Be Filed:  
Tax Years:

UIL: 501.32-00; 501.32-01; 501.33-00

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Holly O. Paz  
Director, Exempt Organizations  
Rulings and Agreements

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: August 1, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

**LEGEND:**

B = Name  
C = Name  
D = Name  
M = Name  
N = Name  
O = Name  
P = Name  
Q = Date  
-x dollars = Amount

**UIL:**

501.32-00  
501-32-01  
501.33-00

Dear :

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

**Issues**

Do you qualify for exemption under section 501(c)(3) of the Internal Revenue Code?

No, for the reasons stated below.

**Alternative Issue**

In the event that upon appeal you are found to qualify for exemption under Section 501(c)(3) of the Code, should you be classified as a private foundation under Section 509(a) of the Code?  
Yes, for the reasons described below.

## Facts

You were formed as a non-profit corporation on date Q in the state of O by three related individuals, B, C and D. Individual B and C are married and D is their daughter. B and C also have a son, M who is the owner/ producer of the for profit musical theater company, N in foreign country, P. N was formed about three years before you and your name includes the name of N.

Your Articles of Incorporation, in part, state you will organize for the charitable and cultural educational purposes of providing financial assistance, either directly or by way of contribution, in support of the theatrical arts in foreign country P; providing such financial assistance to enable production companies in foreign country P to continue to offer performances for the public and thus endow the community with the benefits that exposure to the cultural arts provides.

Your form 1023 indicates you will provide funds to either individuals or organizations in the business of producing American musical theatre or songs in foreign country P. Moreover, individuals who are related to the directors may receive funds if they are engaged in the business of producing American musical theatre or song in foreign country P. In general, donations will be made to production companies that have existed for more than three years and have received favorable reviews from the media in the foreign country of P. You may consider funding new entities, who show potential as best as you can determine through the media in foreign country P. You ensure your assets are used for their intended purposes because "Performances are listed on the internet." When asked what reports or other mechanisms are used to track the use of your assets you again referred to your statement that "Performances are listed on the internet."

B's contributions to you make up 86% of your total revenue received. To date, you have only contributed to N, which account for over 90% of your gross revenue and all your disbursements.. Furthermore, you submitted an executed grant agreement contract with N shows you have approved a grant for up to x dollars. The contract states the funds are designated to assist in the promotion of American musical theater and song in foreign country P and is for the production of a specific American musical theater play. The grantee must also submit a full accounting of the sales and expenses. It further stipulates:

"In the event there is a profit the producer may retain 50% thereof as compensation and the remaining 50% shall be applied to the next production, or if there is no next production or the next production fails to meet the standards of the Corporation as set forth herein, the remaining 50% shall be returned to the Corporation up to the amount of the grant."

B, C and D compose your governing body.

You submitted prints from N's website. The website, in part, indicates that B and C are, "...generous friends..." of for-profit N.

You do not have promotional literature, but you intend to establish a website.

## Law

Section 501(a) of the Code of 1986 provides for the exemption from federal income tax for organizations described in Section 501(c)(3). Such organizations are recognized as exempt if they are organized and operated exclusively for religious, charitable, and educational purposes.

Section 507(d)(2) of the Code defines the term "substantial contributor" as any person who contributed an aggregate amount of more than \$5,000 to the foundation, if such amount is more than 2 percent of the total contributions received by the foundation before the close of the taxable year in which the contribution is received.

Section 509(a)(2)(A) of the Code requires at least one-third of support from gifts, grants, contributions, membership fees and "gross receipts."

Section 509(a)(2)(B) of the Code requires that not more than one-third of support be derived from investment income and unrelated business taxable income and are to be computed on the basis of the organization's normal sources of support.

Section 4946 of the Code provides, in part, that the term "disqualified person" means, with respect to a private foundation, a person who is a substantial contributor to a foundation. Section 1.170A-9(e)(1) of the regulations provides that an organization is described in section 170(b)(1)(A)(vi) of the Code if it is referred to in section 170(c)(2) and is 'publicly supported'.

Section 1.170A-9(e)(2) of the regulations provides that an organization will be treated as a 'publicly supported' organization if it normally receives 33 1/3 percent of its total support from a governmental unit or from direct or indirect contributions from the general public.

Section 1.170A-9(e)(iii) of the regulations states that the higher the percentage of public support, the less the burden to the organization of establishing the publicly supported nature of their organization.

Section 1.170A-9(e)(3) of the regulations provides that if an organization fails to meet the 33-1/3 percent-of-support test, it will be treated as a publicly supported organization if it normally receives at least 10 percent of its support from governmental units, from contributions made directly or indirectly by the general public, or from a combination of these sources. An organization must also maintain a continuous and bona fide program for solicitation of funds from the general public and have a governing body representative of the broad interest of the public.

Section 1.70A-9(e)(3)(vi) of the regulations states that an organization that generally provides facilities or services directly for the benefit of the general public on a continuing basis will be considered evidence that the organization is publicly supported.

Section 1.170A-9(e)(4)(i) of the regulations provides that an organization will be considered 'normally' meeting the 33 1/3 percent-of-support test for its current taxable year and the taxable year immediately succeeding its current year, if, for the four taxable years immediately preceding the current taxable year, the organization meets the 33 1/3 percent-of-support test on the aggregate basis.

Section 1.170A-9(e)(7)(i) of the regulations provides, in part, that for purposes of determining compliance with the 33 1/3 percent-of-support test, the term 'support' does not include any amounts received from the exercise or performance by an organization of its exempt purposes or function. Subdivision (ii) provides that, notwithstanding subdivision (i), an organization will not be treated as satisfying the 33 1/3 percent-of-support test if it receives: (a) almost all of its support from gross receipts from related activities, and (b) an insignificant amount of its support from governmental units and contributions made directly or indirectly by the general public.

Section 1.501(c)(3)-1(a)(1) of the regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(a)-1(c) of the regulations provides that the terms "private shareholder or individual" in Section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals as defined in Section 1.501(a)-1(c).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an exempt organization must serve a public rather than a private interest. The organization must demonstrate that it is not organized or operated to benefit private interests such as "designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Thus, if an organization is operated to benefit private interests rather than for public purposes, or is operated so that there is prohibited inurement of earnings to the benefit of private shareholders or individuals, it may not retain its exempt status.

In Rev. Rul. 76-206, 1976-1 C.B. 154, a nonprofit organization was held not to be exempt under section 501(c)(3) of the Code. The organization was formed to generate interest in retention of classical music programs by a local for profit radio station. The nonprofit organization aided the for profit radio station by seeking program sponsors, encouraging continuing support from existing sponsors, and by various other means to aid the radio station. Such activities tended to increase the revenues of the radio station. The organization's board did not include any representatives of the radio station. The Service held that where an education organization is serving both public and private interests, the private benefit must be clearly incidental to the overriding public interest.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980), the Sixth Circuit court found that although the organization did serve religious and charitable purposes, it existed to serve the private benefit of its founders, and thus failed the operational test of section 501(c)(3). Control over financial affairs by the founder created an opportunity for abuse and thus the need to be open and candid, which the applicant failed to do.

In KJ's Fund Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 166 F.3d 1200 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under section 501(c)(3) because its activities resulted in a substantial private benefit to its founders.

### **Application of Law**

You are not as described in section 501(c)(3) of the Code because you are not exclusively organized and operated for charitable or educational purposes.

You are not as described in Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations because you fail the operational test.

As described in section 1.501(c)(3)-1(c)(2) of the Regulations, you are not operated exclusively for exempt purposes because your net earnings are inuring to B and C. This is evidenced by the fact that you have received 86% of your revenue from B and C; you have turned over essentially all your revenue to M's for profit company N. Moreover, inurement is indicated by the fact that the board members consist of the same family and control all aspects of the grant program including the advertising, the eligibility criteria, the application procedures, the evaluation process, the selection of recipients and the oversight process.

You are not described in Section 1.501(c)(3)-1(d)(1)(ii) of the regulations. You are operating for the private interests of B, C, M and N. This is evidenced by the following:

- You have received substantially all your income from B and C.
- You have donated substantially all your income to M's for profit N.
- The similarity between your name and N's.
- N's website states B and C are generous friends of N.
- The clause in the grant agreement describing M's compensation arrangement which reads: "In the event there is a profit the producer may retain 50% thereof as compensation and the remaining 50% shall be applied to the next production, or if there is no next production or the next production fails to meet the standards of the Corporation as set forth herein, the remaining 50% shall be returned to the Corporation up to the amount of the grant."

Moreover, you have not advertised your grant program and your eligibility criteria are tailored to N. These facts illustrate you are operating for private interests.

You are similar to the organization in Rev. Rul. 76-206, because your operations are substantially benefitting a for profit. Although you may be supporting an educational cause by promoting musical theater, the funds you provide N result in private benefit because the funds permit N to expand its operations and therefore increase its revenue and enhance its value.

You are like the organization in Better Business Bureau v. Commissioner. Although your organization may have some educational activities, the presence of the non-exempt purpose of providing funding to N the for profit company of M precludes exemption.

You are like the organizations in Basic Bible Church v. Commissioner and in KJ's Fund Raisers v. Commissioner, supra. Even if you do serve some educational purposes, your activities of providing funding to M's for profit indicates you have primarily existed to serve the private benefit of your founders and their relatives and thus fail the operational test of section 501(c)(3).

#### **Alternate Issue:**

You are not an organization described in section 509(a)(1) of the Code because you are not an organization described in sections 170(b)(1)(A)(i) through 170(b)(1)(A)(v) of the Code. Further, you are not an organization described in section 170(b)(1)(A)(vi) of the Code because you failed to meet either the 33-1/3 percent-of-support test or the 10 percent facts and circumstances test. In this regard, it is provided in section 1.170A-9(e)(6) of the Income Tax Regulations that in determining whether or not such tests are met, support from direct or indirect contributions from the general public includes contributions from an individual, trust, or corporation but only to the extent that the total contribution from a single such individual, trust, or corporation does not exceed 2 percent of the organization's total support. Your founder provided 94% of your financial support. Your public support percentage is 6%. Therefore, you do not meet the 33-1/3 percent-of-support test as described above.

Further, you are not an organization described in section 509(a)(2) of the Code because you do not meet the support tests provided in sections 509(a)(2)(A) and 509(a)(2)(B) of the Code. A review of the financial information you submitted indicates that you do not meet the support test to be described under Section 509(a)(2), as you have received 86% of your revenue from your founder. Your public support percentage under Section 509(a)(2) is 14%.

As you have failed the public support tests, you are a private foundation if upon appeal exemption is granted.

#### **Applicant's Position**

Your purpose is to promote the advancement of American musical theater and song in P. N has existed for three years and maintains a quality level of performance that meets your minimum standards. The market in P is a difficult one, requiring outside financial assistance. Other organizations, whether non-profit or for-profit, will be assisted if they can achieve a certain quality level.

#### **Service Response to Applicant's Position**

You failed to provide any additional information from which it can be concluded that your activities exclusively further or advance a purpose described in Section 501(c)(3). Even though some of your activities may be educational, you are operating to benefit M and N. Moreover, your criteria for funding and distributions are evidence you were formed to support M and his for profit business, N. Because M is the brother and son of your board members, the result is inurement. The possibility of distributing funds to other organizations does not overcome inurement as any inurement is sufficient to deny.

## Conclusion

Based on the information submitted, you are not operating exclusively for one or more purposes described in section 501(c)(3) of the Code. Your net earnings inure to the benefit of insiders causing you to be precluded from exemption under Section 501(c)(3) of the Code. In addition, you are operating for the benefit of M, a for profit company.

## Conclusion-Alternative Issue

If, upon appeal, you qualify for exemption, , you would be classified as a private foundation, because you have failed the public support tests, as described above.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

*Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:*

*"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."*

*The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.*

*Your appeal will be considered incomplete without this statement.*

*If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.*

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal

as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

**Mail to:**

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

**Deliver to:**

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Holly O. Paz  
Director, Exempt Organizations  
Rulings and Agreements

Enclosure, Publication 892